

# **Legislative Audit Division**

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**State of Montana**



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**Report to the Legislature**

**November 2004**

## **Financial-Compliance Audit**

**For the Two Fiscal Years Ended June 30, 2004**

### **Department of Natural Resources and Conservation**

**This report contains fifteen recommendations. Issues addressed in the report relate to:**

- **Internal Control and Accounting Oversight**
- **Cooperative Forestry Assistance Federal Award Administration**
- **Fire Expenditure Internal Control and Documentation**
- **Accounting Issues**
- **Compliance with State and Federal Laws and Regulations**

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Government Auditing Standards, the Single Audit Act Amendments of 1996 and OMB Circular A-133 require the auditor to issue certain financial, internal control, and compliance reports. This individual agency audit report is not intended to comply with these reporting requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 2005, will be issued by March 31, 2006. The Single Audit Report for the two fiscal years ended June 30, 2003, was issued on March 23, 2004. Copies of the Single Audit Report can be obtained by contacting:

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# LEGISLATIVE AUDIT DIVISION

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November 2004

The Legislative Audit Committee  
of the Montana State Legislature:

This is our financial-compliance audit report on the Department of Natural Resources and Conservation for the two fiscal years ending June 30, 2004. The report contains a qualified opinion on the Department's financial schedules. Included in this report are fifteen recommendations to the Department primarily related to internal control and compliance with state and federal laws and regulations. The Department's written response to audit recommendations is included in the audit report.

We thank the director and his staff for their cooperation and assistance throughout the audit.

Respectfully submitted,

*(Signature on File)*

Scott A. Seacat  
Legislative Auditor

# **Legislative Audit Division**

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## **Financial-Compliance Audit**

**For the Two Fiscal Years Ended June 30, 2004**

## **Department of Natural Resources and Conservation**

Members of the audit staff involved in this audit were Laurie Barrett, Jennifer Erdahl, Brenda Kedish, Cindy S. Jorgenson, Alexa O'Dell, Vickie Rauser and Jeff Tamblyn.

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## **Appointed and Administrative Officials**

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### **State Board of Land Commissioners**

Judy Martz, Governor  
John Morrison, State Auditor  
Bob Brown, Secretary of State  
Linda McCulloch, Superintendent of Public Instruction  
Mike McGrath, Attorney General

### **Administrative Officials**

Arthur “Bud” Clinch, Director

Ann Bauchman, Centralized Services Division Administrator

Ray Beck, Conservation and Resource Development Division  
Administrator

Bob Harrington, Forestry Division Administrator

Tom Richmond, Oil and Gas Conservation Division  
Administrator

Jack Stults, Water Resource Division Administrator

Susan Cottingham, Reserved Water Rights Compact  
Commission Program Manager

Tom Schultz, Trust Land Management Division  
Administrator

Tommy Butler, Co-Chief Legal Counsel

Tim Hall, Co-Chief Legal Counsel

### **Administratively Attached Boards & Committees**

Board of Water Well Contractors  
Board of Oil and Gas Conservation  
Reserved Water Rights Compact Commission  
Rangeland Resources Executive Committee  
Drought Advisory Committee  
Resource Conservation Advisory Council  
Montana Grass Conservation Commission  
Missouri River Basin Advisory Council  
Flathead Basin Commission  
Montana Agricultural Heritage Commission

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### Department of Natural Resources and Conservation

This report documents the results of our financial-compliance audit of the Department of Natural Resources and Conservation (Department) for the two fiscal years ended June 30, 2004. The previous report contained eight recommendations to the Department. The Department implemented five recommendations and did not implement three recommendations.

This report contains fifteen recommendations directed to the Department. The recommendations address internal control and accounting oversight; Cooperative Forestry Assistance federal award administration; fire expenditure internal control and documentation; accounting issues; and compliance with state and federal laws and regulations.

We issued a qualified opinion on the financial schedules contained in the report. This means the reader should use caution in relying on the presented financial information as well as the supporting data on the state's accounting system.

The Department's written response to the audit begins on page B-3.

The listing below serves as a means of summarizing the recommendations contained in the report, the Department's response thereto, and a reference to the supporting comments.

#### Recommendation #1

We recommend the Department:

- A. Establish, document, and monitor internal control over compliance with requirements for the Cooperative Forestry Assistance federal award.
- B. Reimburse the United States Department of Agriculture \$6,878 for unallowable costs charged to the Cooperative Forestry Assistance federal award. .... 11

Department Response: Concur. See page B-3.



## Report Summary

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<u>Recommendation #2</u>	We recommend the Department clarify and enforce its policy regarding the review, approval, and processing of claims. .... 13
	<u>Department Response:</u> Concur. See page B-3.
<u>Recommendation #3</u>	We recommend the Department establish procedures to verify the accuracy of recorded revenue estimates..... 15
	<u>Department Response:</u> Concur. See page B-3.
<u>Recommendation #4</u>	We recommend the Department establish procedures to ensure distributions of unrealized investment income are properly classified on the state’s accounting records. .... 16
	<u>Department Response:</u> Concur. See page B-3.
<u>Recommendation #5</u>	We recommend the Department review federal revenue accruals and deferrals for compliance with state accounting policy and process necessary correcting entries. .... 17
	<u>Department Response:</u> Concur. See page B-3.
<u>Recommendation #6</u>	We recommend the Department establish procedures to ensure bond and note payables are properly classified on the state’s accounting records. .... 18
	<u>Department Response:</u> Concur. See page B-3.
<u>Recommendation #7</u>	We recommend the Department record infrastructure transactions in accordance with state accounting policy..... 19
	<u>Department Response:</u> Concur. See page B-4.
<u>Recommendation #8</u>	We recommend the Department place Permanent Fund timber sale revenues in the state timber sale account as prescribed by state law. .... 20
	<u>Department Response:</u> Concur. See page B-4.

## Report Summary

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<u>Recommendation #9</u>	We recommend the Department take immediate measures to resolve the conflict in state law related to the use of Public School Fund mineral royalties and other permanent fund revenues to finance the cost of administering state trust land. ....	21
	<u>Department Response:</u> Do not concur. See page B-4.	
<u>Recommendation #10</u>	We recommend the Department comply with state law by distributing Montana University System trust fund timber revenues.....	22
	<u>Department Response:</u> Concur. See page B-4.	
<u>Recommendation #11</u>	We recommend the Department report grazing, agricultural and forestland acreage to the Department of Revenue as required by state law. ....	23
	<u>Department Response:</u> Concur. See page B-4.	
<u>Recommendation #12</u>	We recommend the Department process surface and ground water rights applications in the timeframes required by state law. ....	24
	<u>Department Response:</u> Concur. See page B-5.	
<u>Recommendation #13</u>	We recommend the Department review state water reservations as required by state law. ....	25
	<u>Department Response:</u> Concur. See page B-5.	
<u>Recommendation #14</u>	We recommend the Department submit fire cost protection assessment information by the deadline established in state law. ....	25
	<u>Department Response:</u> Concur. See page B-5.	

## Report Summary

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### Recommendation #15

We recommend the Department establish procedures to ensure its annual Schedule of Expenditures of Federal Awards and summary of subgrant activity are complete and contain accurate information as required by OMB Circular A-133 and the Single Audit Act Amendments of 1996. .... 26

Department Response: Concur. See page B-6.

# Introduction

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## Introduction

We performed a financial-compliance audit of the Montana Department of Natural Resources and Conservation (Department) for the two fiscal years ended June 30, 2004. The accompanying financial schedules include activity that is audited separately by us. The Montana Water Pollution Control and Drinking Water State Revolving Fund Programs (03SP-85) audit is available upon request.

The objectives of this audit were to:

1. Determine the Department's compliance with state laws and regulations.
2. Provide Department management with recommendations for improvement in management and internal controls.
3. Determine the Department's compliance with federal regulations applicable to major federal programs, including the implementation of internal control over compliance.
4. Determine if the Department's financial schedules fairly present the results of operations and changes in fund balances for the two fiscal years ended June 30, 2004.
5. Determine the implementation status of prior audit recommendations.

This report contains fifteen recommendations to the Department. Other concerns not having a significant effect on the successful operations of the Department are not specifically included in this report but have been discussed with management.

In accordance with section 5-13-307, MCA, we analyzed and disclosed the cost, if significant, of implementing the recommendations made in this report. We evaluated charges for services in the Internal Service Fund as required by section 17-8-101(6), MCA, and found the charges and fund equity reasonable for the operations in the fund in fiscal years 2002-03 and 2003-04.

## Introduction

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### Background Information

The Executive Reorganization Act of 1971 established a department to manage the state's natural resources. In 1995, the reorganization of Montana's natural resources and environmental agencies created the current Department of Natural Resources and Conservation. The mission statement of the Montana Department of Natural Resources and Conservation is:

“To help ensure Montana's land and water resources provide benefits for present and future generations.”

The Department executes its mission by promoting the stewardship of Montana's water, soil, forest, and rangeland resources, and regulating forest practices and oil and gas exploration and production.

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### Department Organization

The Department is organized into the following divisions.

Centralized Services Division (37 FTE) provides managerial and administrative support services to the Department through the Director's Office and Support Services. The Director's Office includes the director, legal staff, and public information personnel. Support Services includes fiscal affairs, data processing, personnel, reception, and mail. The division manages all financial activities, coordinates information systems and procurement, produces publications and graphic materials, and performs general administrative support services. Other responsibilities include trust revenue collection and distribution, and maintenance of ownership records for trust and non-trust state-owned land.

Oil and Gas Conservation Division (20.5 FTE) administers the Montana oil and gas conservation laws. It promotes conservation and prevents waste in the recovery of oil and gas resources through regulation of exploration and production. The division issues drilling permits; classifies wells; establishes well spacing units and pooling orders; inspects drilling, production, and seismic operations; investigates complaints; and does engineering studies. The division also determines incremental production for enhanced recovery and horizontal wells in order to implement the tax incentive program for

those projects; operates the underground injection control program; plugs orphan wells; and collects and maintains complete well data and production information. The division provides administrative support to the Board of Oil and Gas Conservation.

Conservation and Resource Development Division (21.5 FTE) is responsible for administering the Conservation District Act, the Montana Rangeland Resources Act and the Natural Streambed and Land Preservation Act. In doing so, the division provides technical, administrative, financial and legal assistance to Montana's 58 conservation districts. The division also manages several loan and grant programs for local communities, local governments, state agencies and private citizens. The programs include State Revolving Fund loans to communities for water and waste water systems; Coal Severance Tax loans to governmental entities; and private loans. Loans outstanding exceed \$185 million at June 30, 2004. Grant programs administered by the division include the Reclamation Development, Renewable Resource, and Conservation District grant programs.

Water Resources Division (109.5 FTE) is responsible for programs associated with the use, development, and protection of Montana's water. It manages and maintains the state-owned dams, reservoirs, and canals. The division develops and recommends intrastate, interstate, and international water policy to the director, governor, and legislature. The division also resolves water resource use conflicts, investigates water use violations, ensures dam safety compliance, and provides water adjudication support to the Water Court. The division consists of an administration unit and four bureaus: Water Management Bureau, Water Rights Bureau, State Water Projects Bureau, and the Water Operations Bureau. The 2003 Legislature attached the Flathead Basin Commission to the Department for administrative purposes. The Commission is charged with protecting the natural resources and environment of the Flathead Basin.

## Introduction

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Reserved Water Rights Compact Commission (9 FTE) was created by the legislature in 1979 as part of the water rights adjudication effort. The commission negotiates water rights with Indian Tribes and federal agencies claiming federal reserved water rights within the state in order to establish a formal agreement or compact on the amount of water to be allocated to each interest.

Forestry Division (163.05 FTE) is responsible for planning and implementing forestry programs statewide. The division protects Montana's natural resources from wildfire, regulates forest practices, and provides a variety of services to private forest landowners. The Fire and Aviation Management Program protects 50 million acres of state and private forest and watershed lands from wildfire through a combination of direct protection and county support. The Forest Practice Regulation program enforces Montana's streamside management zone regulations and monitors the voluntary best management practices program on all forests in Montana. In administering Montana's Fire Hazard Reduction Law, the division ensures fire hazards created by logging and other forest management operations on private forestlands are adequately reduced, or that additional fire protection is provided until the hazard is reduced. The division provides technical forestry assistance to private landowners, businesses and communities. It also operates the Tree and Shrub Nursery program, which involves growing and selling seedlings for conservation and reforestation plantings on state and private lands in Montana. In fiscal year 2002-03, the division sold 892,500 seedlings, generating gross revenues of \$326,667. In fiscal year 2003-04, 1,051,130 seedlings were sold for \$360,991.

The Trust Land Management Division (125.71 FTE) provides for the administration and management of trust lands granted to the state of Montana by the Enabling Act of 1889. In the process of producing revenue for trust beneficiaries, the division considers environmental factors and protects the future income-generating capacity of the trust lands. These lands currently total 5.2 million surface acres and 6.2 million mineral acres. Additionally, the division is responsible for the administration of approximately 6,000 miles of the beds of

navigable waterways. The Trust Land Management Division is divided into four primary programs: forest management, agriculture and grazing management, special use management and minerals management.

The State Board of Land Commissioners, comprised of the Governor, State Auditor, Attorney General, Superintendent of Public Instruction, and Secretary of State, exercise the general authority, direction, and control over the care, management, and disposition of state lands under its administration. The Department director is the chief administrative officer of the board.

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### **Prior Audit Recommendations**

We performed an audit of the Department for the two fiscal years ended June 30, 2002. The report contained eight recommendations. The Department implemented five and did not implement three of the recommendations. The recommendations not implemented are addressed again in the current report. Federal revenue accruals and deferrals are discussed on page 16. The accuracy and completeness of the Schedule of Expenditures of Federal Awards is discussed on page 25. Issues related to properly recording accounting transactions and establishing internal control to prevent and detect errors are discussed on pages 7 through 20.





# Findings and Recommendations

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## Internal Control and Accounting Oversight

State law addresses legal requirements related to fiscal control and accountability. Section 17-1-102, MCA, requires each agency to record the transactions necessary to ensure its accounting records present the receipt, use, and disposition of all money and property for which it is accountable in accordance with generally accepted accounting principles by the close of each fiscal year. Management Memo 2-00-2 states that state agencies are responsible for implementing internal control procedures to ensure compliance with section 17-1-102, MCA.

Our prior audit report discussed the need for accounting oversight within the Department. Recommendations one through eight in this report also address concerns related to fiscal and legal accountability. These issues address areas where the Department can improve its control structure. A properly implemented control structure will allow the Department to prevent, or detect in a timely manner, errors in its financial records or instances of non-compliance with state and federal laws and regulations.

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## Cooperative Forestry Assistance Federal Award, Internal Control & Compliance

**Noncompliance with federal laws and regulations resulted from the Department's failure to enforce internal control and provide accounting oversight for the Cooperative Forestry Assistance federal award.**

The Department uses the Cooperative Forestry Assistance (CFA) federal award to administer programs such as forest stewardship and health; conservation education; volunteer and state fire assistance; and urban and community issues. The CFA award is considered a major award for the state of Montana beginning with fiscal year 2001-02. Four agencies, including the Department, incur expenditures under this award. We reviewed the Department's compliance with applicable federal laws and regulations during fiscal years 2001-02 through 2003-04. The Department expended \$2,419,204 in fiscal year 2001-02; \$2,788,581 in fiscal year 2002-03; and \$1,841,499 in fiscal year 2003-04 under this award.

## **Findings and Recommendations**

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Office of Management and Budget (OMB) Circular A-133 requires the Department to maintain internal control that provides reasonable assurance a federal award is managed in compliance with laws, regulations, and the provisions of the grant agreements that could have a material effect on the award. The Department did not comply with this requirement. The results of our work are discussed below.

### **Cash Management**

Federal regulations require the Department to establish procedures to minimize the time between the transfer of funds from the U.S. Treasury and the related disbursement. Department personnel stated they review a cash report weekly to determine when draws should occur. Department personnel were unable to provide documentation demonstrating the weekly review occurred or that they established adequate control over compliance with this requirement. We reviewed cash draws recorded on the primary accounting records for fiscal years 2001-02 through 2003-04. Overall, we noted a lack of consistency in the timing of the cash draws and little correlation between the amount drawn and the related expenditure activity.

We also noted several instances where the Department did not minimize the time elapsing between the transfer of funds from the U.S. Treasury and the related disbursements. In fiscal year 2001-02, the Department took two and one-half months to expend one draw of \$781,595 and one and one-half months to expend another draw of \$237,045. In fiscal year 2002-03, the Department took seven months to expend the cash received in two back-to-back draws totaling \$1,428,464 and three months to expend another two back-to-back draws totaling \$1,480,533. In fiscal year 2003-04, four cash draws totaling \$2,259,968 were made in August, September, and December 2003. No additional draws occurred after December 2003 even though the Department continued to incur expenditures.

### **Timeliness & Accuracy of Federal Financial Reports**

Effective October 1, 2002, the grant agreements for this award require the Department to submit financial status reports on a quarterly basis. Prior to that, the reports were to be submitted on an annual basis. The financial status report identifies the program outlays made during the grant award period. Because the employee

## Findings and Recommendations

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responsible for these reports is no longer with the Department, current personnel were unable to describe the control procedures used to ensure these reports are prepared and submitted as required. In addition, no one was responsible for reviewing and approving these reports. Department personnel were able to locate only one of the estimated 16 financial status reports they were required to prepare and file for fiscal years 2001-02, 2002-03, and 2003-04.

We reviewed the available financial status report and believe the report is inaccurate. Reported expenditures are approximately \$720,000 greater than expenditures recorded on SABHRS for the same time period.

### **Eligibility**

The CFA award provides resources for local firefighting organizations submitting grant proposals to the Department. Only local firefighting organizations serving communities with a population under 10,000 are eligible for these funds. Department personnel have no documentation demonstrating local firefighting organization eligibility was considered in the subgrant approval process during fiscal years 2001-02 through 2003-04. While we did not identify ineligible firefighting organizations, the potential exists for an ineligible organization to receive funds.

### **Matching**

Federal regulations require the Department to use state funds in addition to federal funds in administering the CFA award. While our review of the primary accounting records indicated the Department complied with this matching requirement, Department personnel were unable to demonstrate they reviewed the primary accounting records or summary reports to ensure compliance.

### **Period of Availability and Unallowable Costs**

Federal regulations prohibit the Department from charging costs to a federal award when the underlying obligation is incurred outside of the funding period established in the grant agreement. In fiscal year 2001-02, the Department used CFA funds to pay \$6,878 to the Public Employees' Retirement System (PERS) on behalf of a part-time employee. Under state law, membership in PERS was mandatory for this employee between December 1993 and March 1996.

## **Findings and Recommendations**

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Department personnel miscalculated the hours worked by the employee, did not realize the employee met the criteria and did not make the contributions at the time the obligation was incurred. Since this obligation occurred outside of the current CFA award period, it is unallowable. The Department employee authorizing the payment specified in writing that it should be charged to the General Fund, but other department personnel charged the payment to the CFA award based on the accounting cost center designated on the support. The Department should reimburse the federal grantor agency for \$6,878 charged to the CFA award in fiscal year 2001-02.

### **Commingled Expenditures on the Financial Records**

Federal regulations require the Department to maintain fiscal control and accounting procedures that allow for preparation of required reports and demonstrate proper use of federal funds. During our review of CFA activity, we observed the procedures used by the Department resulted in co-mingled state and federal expenditures. The Department uses multiple accounting cost centers to account for CFA expenditures. The expenditures recorded in these cost centers are not limited to CFA federal expenditures, but also include state funds. In addition, three of the cost centers used in fiscal year 2003-04 also contain other federal award activity. Even after analyzing the activity in these three cost centers using other identifying information, such as fund and program, we were unable to isolate CFA expenditures. We believe the structure of the financial records impairs the Department's ability to prepare accurate financial reports and demonstrate proper management of the funds. We also believe it contributed to the federal financial report and Schedule of Expenditures of Federal Awards issues on pages 8 and 25, respectively.

### **Summary**

Department personnel indicated employee turnover and growth in complexity and size of the award over time impacted their ability to administer this award in accordance with federal law and regulations. We observed that policies and procedures were not documented and management did not establish internal control over compliance. Due to the extent of noncompliance observed, we believe the Department needs to establish internal control, including monitoring procedures, for this program. Documenting the policies and procedures will be necessary to clearly communicate expectations to employees and

## Findings and Recommendations

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demonstrate the internal control required by federal law and regulation has been established. Monitoring employee application of policy and procedures will be necessary to ensure internal control provides reasonable assurance the federal award is managed in compliance with laws, regulations, and the provisions of the grant agreements.

### **Recommendation #1**

**We recommend the Department:**

- A. Establish, document, and monitor internal control over compliance with requirements for the Cooperative Forestry Assistance federal award.**
- B. Reimburse the United States Department of Agriculture \$6,878 for unallowable costs charged to the Cooperative Forestry Assistance federal award.**

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### **Fire Expenditures**

**During the 2003 fire season, the Department was inconsistent in its application of described internal control over fire costs.**

The Department is responsible for wildfire suppression on over 50 million acres of state and private property. The Department expended approximately \$6.7 million and \$79 million in fiscal years 2002-03 and 2003-04, respectively, in wildfire suppression activities. During our audit, we reviewed fire expenditure activity. Issues pertinent to the scope of our performance audit on wildfire suppression (04P-11) were referred for that audit's consideration. The following paragraphs outline our concerns related to described internal control and documentation.

### **Internal Control**

In conjunction with the planning of the performance audit on wildfire suppression, we tested 31 fire equipment and suppression services vendor payments for fiscal year 2003-04 totaling \$334,468. Department personnel indicated all documentation supporting vendor payments is retained in Centralized Services Division (CSD). We observed that the internal control described by Department personnel was not consistently applied. Specifically, we noted instances where

## **Findings and Recommendations**

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the documentation submitted to CSD personnel to initiate a vendor payment was incomplete or inaccurate. When an invoice for equipment rental is received, CSD personnel review attached vehicle inspection forms, rental agreements, and shift tickets prior to approval. Of the items reviewed, 10 were either missing a vehicle inspection form or had an inspection completed after the vehicle was placed in operation. One item had no rental agreement. Two items did not contain shift tickets or order invoices, which document the timeframe in which equipment is used on a fire.

Due to the possible significance our observations could have on overall fire management, we referred the results of our review to the performance audit on fire suppression for expanded testing. Additional testing performed during the performance audit revealed that the supporting documentation is maintained in the field offices.

### **Falsified Meal Invoices**

The Department provides meals for firefighters involved in fire suppression activities. During our audit, we reviewed expenditure transactions for firefighter meals. We identified nine payments totaling \$519 made to a restaurant in July and August 2003 that contained falsified invoices. The payments were for meals obtained by individuals not employed by the Department who assisted with fire suppression activities. The invoices and restaurant receipts submitted to the Department do not agree regarding the number of individuals served. Specifically, the vendor invoice indicates the purchase does not exceed per meal limits established by the Department, whereas the restaurant receipts indicate the limits were exceeded. We estimate the department paid \$155 in excess of allowable per diem as a result of the falsified invoices. As required by state law, we referred this matter to the Attorney General.

### **Inadequate Meal Documentation**

As part of our review of expenditure transactions for firefighter meals, we identified nine payments to meal providers totaling \$1,387 containing insufficient documentation. Of these, two payments were made without the vendor invoice that generally documents the maximum allowable meal cost and department pre-approval. Three of the payments were made based on a credit card receipt rather than

## Findings and Recommendations

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an itemized receipt from the vendor. Appropriate detailed documentation is necessary for Department personnel to determine if claims are valid, belong to the Department, and comply with applicable laws and regulations. Inadequate documentation can also limit the Department's ability to fully recover federal funds. OMB Circular A-87 requires adequate documentation for costs to be considered allowable.

Of these transactions, four relate to fires deemed eligible for reimbursement by the Federal Emergency Management Agency (FEMA). We reviewed the documents supporting the FEMA reimbursements in fiscal year 2003-04. We determined \$317 of the overpayments described above was reimbursed by FEMA. We question \$317 in costs charged to the Fire Management Assistance Award, but believe potential questioned costs for this award could exceed \$10,000.

### Summary

Department personnel believe these issues resulted from the extreme nature of the 2003 fire season. Department personnel experienced difficulty in determining the cause of the falsified invoices because the individuals involved were not department employees. In response to these issues, department personnel established new procedures related to meals and payment of invoices in preparation for the 2004 fire season. Department personnel also provided additional training to employees regarding proper documentation and meal limits. We believe department personnel should also monitor the processing of claims on a regular basis to verify internal control is operating as intended.

As stated previously, we referred the results of our work to the performance audit on wildfire suppression for expanded testing.

#### **Recommendation #2**

**We recommend the Department clarify and enforce its policy regarding the review, approval, and processing of claims.**



## Findings and Recommendations

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### Accounting Errors

During the audit, we identified account balances on the primary accounting records that were not recorded in accordance with state law and policy. State law requires the Department to input all necessary transactions before the end of the fiscal year to present the receipt, use, and disposition of all money and property, for which it is accountable, in accordance with generally accepted accounting principles (GAAP). The Department of Administration establishes state accounting policy to implement this law. Each of these accounting issues results from an inadequate review of accounting transactions and reports for the purpose of ensuring the accounting records are complete and accurate. The following paragraphs describe the instances noted.

### Negative Revenue Estimates

#### **Revenue estimate errors contributed to the Independent Auditor's Report qualification.**

The Department of Administration reports revenue by function, or type of activity, in the Basic Financial Statements for the state of Montana. Historically, the primary accounting records haven't provided function designations for revenue activity. In fiscal year 2003-04, state accounting policy required Department personnel to establish this designation on the primary accounting records for its revenues, including its nonbudgeted revenues. To accomplish this, Department personnel were required to establish revenue estimates for all revenues. Department personnel coded the estimates for nonbudgeted revenues as negative, rather than positive, amounts due to a misunderstanding about data entry requirements.

## Findings and Recommendations

Table 1 below lists the revenue estimate errors by fund impacting the financial schedule on page A-7.

<b>Table 1</b>	
<b><u>Revenue Estimate Errors by Fund</u></b>	
Fiscal Year 2003-04	
	Amount <u>Understated</u>
State Special Revenue Fund	\$ (1,105,300)
Federal Special Revenue Fund	(15,000)
Debt Service Fund	(731,800)
Permanent Fund	(42,532,400)
<b>Source: Compiled by the Legislative Audit Division from Statewide Accounting, Budgeting, and Human Resources System.</b>	

Revenue estimates for nonbudgeted activity provide no meaningful data, as actual collections retain the nonbudgeted classification. Department of Administration personnel indicated the requirement to designate function for revenues was eliminated for fiscal year 2004-05 because the process did not work properly in fiscal year 2003-04. This issue contributed to the Independent Auditor's Report qualification described on page A-3. Department personnel could have mitigated these errors by reviewing revenue estimate reports and correcting negative estimates.

### **Recommendation #3**

**We recommend the Department establish procedures to verify the accuracy of recorded revenue estimates.**

#### **Permanent Fund Prior Year Revenue and Expenditure Adjustments**

**Errors in Permanent Fund Prior Year Revenue and Expenditure Adjustments contributed to the Independent Auditor's Report qualification.**

Department personnel annually distribute unrealized investment income to the permanent funds administered by the Department. In fiscal year 2003-04, Department personnel coded a portion of that

## Findings and Recommendations

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allocation as prior year adjustment activity. State accounting policy indicates a prior year adjustment is to be processed when correcting an error made in the prior fiscal year. The distribution was related to current year activity only. Table 2 below summarizes the misstatements contained on the state's accounting records.

<b>Table 2</b>	
<b><u>Permanent Fund</u></b>	
<b><u>Prior Year Revenue and Expenditure Adjustments Errors</u></b>	
Fiscal Year 2003-04	
	<u>Over(Under)Stated</u>
Prior Year Revenues & Transfers-In Adjustments	\$(40,374,975)
Nonbudgeted Revenues & Transfers-In	40,374,975
Prior Year Expenditures & Transfers-Out Adjustments	(40,374,975)
Nonbudgeted Expenditures & Transfers-Out	40,374,975

**Source: Compiled by the Legislative Audit Division from the Statewide Accounting, Budgeting and Human Resources System.**

This issue contributed to the Independent Auditor's Report qualification described on page A-3. Department personnel should more thoroughly review accounting transactions and reports to ensure transactions are recorded in accordance with state accounting policy.

### **Recommendation #4**

**We recommend the Department establish procedures to ensure distributions of unrealized investment income are properly classified on the state's accounting records.**

### **Federal Revenue Accruals and Deferrals**

**Improper federal revenue recognition resulted from insufficient accounting oversight.**

State accounting policy requires state agencies to accrue federal revenue earned, but not yet received from the federal government during the fiscal year-end period. In addition, revenue received in advance of expenditure should be deferred. We determined that

## Findings and Recommendations

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revenue accruals and deferrals were not processed in accordance with state accounting policy in fiscal years 2002-03 and 2003-04. Department personnel could have prevented the errors by analyzing fund balances. Fund balance in the Federal Special Revenue Fund on the Schedule of Changes in Fund Balances is overstated by approximately \$532,000 at June 30, 2003, and understated by approximately \$1,038,402 at June 30, 2004. We were unable to conclusively determine the extent of revenue misstatements, as asset and liability accounts may also be misstated. We believe department personnel should review the fiscal year 2002-03 and 2003-04 federal revenue accrual and deferral transactions for compliance with state policy. The Department should process correcting entries to prevent the errors from compounding in future fiscal years.

### **Recommendation #5**

**We recommend the Department review federal revenue accruals and deferrals for compliance with state accounting policy and process necessary correcting entries.**

## **Bonds and Notes Payable**

### **Improper and incomplete processing of bonds and notes payable transactions resulted from insufficient accounting oversight.**

The Department finances several loan and grant programs by issuing bonds or notes. We identified several accounting errors on the state's accounting records related to bonds and notes. Specifically, the Department did not reduce bonds payable for principal prepayments or properly classify the current and long-term portions for its general obligation bonds. In addition, the current portions of the Tongue River and Middle Creek Dam notes were not properly classified on the state's accounting records.

State policy directs the Department to classify the portion of the bond or notes payable that will be paid during the next fiscal year as a current liability. The following table summarizes these errors.

## Findings and Recommendations

**Table 3**

**Bonds and Notes Accounting Errors**  
Fiscal Years Ended June 30, 2003 and 2004

Fund and Account	Over(Under)Stated	
	June 30, 2003	June 30, 2004
<b>Debt Service Fund</b>		
Long-Term Bonds Payable – Non Current	\$ (535,000)	\$ 3,000,000
Long-Term Bonds Payable - Current	985,000	(2,857,000)
Principal Expenditures	450,000	
Fund Balance		(143,000)
<b>State Special Revenue Fund</b>		
Long-Term Notes Payable	329,065	330,555
Short-Term Notes Payable	(329,065)	(330,555)

**Source: Compiled by the Legislative Audit Division from Department Records.**

Department personnel could have identified and prevented these errors by comparing the June 30, 2003, and 2004, payable balances to the bond and note documents or to the prior June 30 balances.

**Recommendation #6**

**We recommend the Department establish procedures to ensure bond and note payables are properly classified on the state's accounting records.**

**Infrastructure Year-End Transactions**

**Errors in infrastructure transactions resulted from insufficient accounting oversight during the fiscal year-end period.**

State accounting policy directs agencies to exercise care in preparing transactions during the fiscal year-end period to ensure transactions are recorded in the proper fiscal year. This can include more thorough reviews of the transactions during the approval process or reviewing reports for both of the fiscal years open during the fiscal year-end period. State accounting policy also prescribes the method

## Findings and Recommendations

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to use when capitalizing infrastructure assets. During fiscal year-end 2002-03, Department personnel capitalized improvements made to the Bair Dam. The initial transaction did not properly record the improvements. Department personnel immediately identified the error and processed a correcting entry. The Department's review and approval process did not, however, identify that the correcting entry was incomplete and coded to the wrong fiscal year. The final correction occurred in April 2004. Land and Interest in Land expenditures in the Water Resources Division are understated by \$2,726,743 on the Schedule of Total Expenditures & Transfers-Out for the fiscal year ended June 30, 2003. The June 30, 2003, fund balance in the State Special Revenue Fund is overstated by the same amount on the Schedule of Changes in Fund Balances & Property Held in Trust. Department personnel should more thoroughly review accounting transactions and reports to ensure transactions, including infrastructure, processed during the fiscal year-end period are recorded in accordance with state accounting policy.

### **Recommendation #7**

**We recommend the Department record infrastructure transactions in accordance with state accounting policy.**

### **State Timber Sale Account**

**The Department deposited an insufficient amount of timber sales revenues in the State Timber Sale Account.**

The Legislature appropriates money in the state timber sale account to the Department for the purpose of enhancing revenues earned on trust lands. Section 77-1-613, MCA, directs the Department to deposit revenue earned from timber sales on state lands into the account equal to the appropriation amount each fiscal year. During fiscal year 2002-03, the Department deposited \$47,952 less than required into the account. Sale of Documents, Merchandise, and Property revenues are understated in the State Special Revenue Fund and Accounting Entity Transfers are understated in the Permanent Fund by \$47,952 in fiscal year 2002-03. Department personnel indicated the additional \$47,952 was not needed for program

## Findings and Recommendations

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operations in fiscal year 2002-03. If the transfer of timber sale revenues required by state law results in the accumulation of excess resources in the state timber sale account, the Department should consider seeking legislation to modify the funding requirement.

### **Recommendation #8**

**We recommend the Department place Permanent Fund timber sale revenues in the state timber sale account as prescribed by state law.**

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### **State Compliance Issues**

During the audit period, the Department did not comply with certain state laws and regulations applicable to its operations. The following sections describe those areas where the Department's compliance with state laws can be improved.

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### **Trust Land Administration Account**

#### **Questions exist concerning the legality of using mineral royalty and other permanent trust revenues to administer trust lands.**

Our prior audit report contained a disclosure issue describing a conflict between the Montana Constitution and state law related to moneys placed in the trust land administration account. We reported that using Public School Fund mineral royalty revenue and other permanent fund revenues to finance administration of state trust land may violate the Montana Constitution. During the current audit, we reviewed the status of this disclosure issue and determined a conflict still exists.

Article X of the Montana Constitution establishes the Public School Fund. It provides that the Public School Fund shall forever remain inviolate, guaranteed by the state against loss or diversion. The Public School Fund is to include proceeds from school lands occurring when the state disposes of trust land or an interest therein. Article X also defines Public School Fund revenue and provides for its distribution, allocating 95 percent for distribution to the public schools and the remaining 5 percent to the Public School Fund.

## Findings and Recommendations

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Article X is silent regarding the cost of administering these trust lands.

Section 77-1-109, MCA, allows the Department to deposit mineral royalties, certain timber and easement revenue, and a portion of the interest and income received by the Public School Fund to the Department's Trust Land Administration Account to pay for its management of trust lands. Since fiscal year 1999-00, approximately \$17.2 million has been deposited to the administration account. These deposits are primarily comprised of Public School mineral royalty revenues, but also include other revenue types.

Sections 77-3-318, 77-3-436, and 77-3-206, MCA, require state land mineral royalty revenues be credited to the appropriate permanent funds, becoming an inseparable and inviolable part of the trust fund corpus.

We believe the Montana Constitution and state law are not consistent regarding the use of Public School Fund mineral royalties and other permanent fund revenues to finance the cost of managing trust land. While Department personnel believe it is appropriate to use permanent fund revenues for trust land administration, they acknowledge that affected parties have not reached a consensus regarding the legality of this practice. To mitigate the risks associated with this question on legality, we believe the Department should take immediate measures to resolve the conflict that exists in law. Available options include, but are not limited to, seeking an Attorney General's opinion, an amendment to the Montana Constitution, or a change in state law.

### **Recommendation #9**

**We recommend the Department take immediate measures to resolve the conflict in state law related to the use of Public School Fund mineral royalties and other permanent fund revenues to finance the cost of administering state trust land.**



## Findings and Recommendations

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### Timber Sale Revenue - Montana University System Trust Funds

#### **The Department illegally allocated timber revenues from Montana University System land to the Trust Land Administration Account.**

Except for timber revenue generated on public school and Montana University Systems (MUS) land, section 77-1-109, MCA, allows the Department to deposit timber revenue in the Trust Land Administration Account. Chapter 420, Laws of 2001, established the exception for MUS timber revenue. The legislation also directs the Department to distribute the MUS timber revenue to the related institution. This legislation was effective July 1, 2001.

During fiscal years 2001-02 and 2002-03, the Department deposited MUS timber revenue in the Trust Land Administration Account. According to Department personnel, the Board of Regents issued a formal policy declaring timber revenue as permanent fund revenue not available for distribution to the institutions. Department personnel indicated they do not allocate distributable income to the trust land administration account. The Department included the MUS timber revenue in the administration allocation because the Board of Regent's policy declared the revenue unavailable for distribution.

#### **Recommendation #10**

**We recommend the Department comply with state law by distributing Montana University System trust fund timber revenues.**

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### Grazing, Agricultural and Forest Land Acreage Reporting

#### **The Department did not report trust land acreage to the Department of Revenue by property type.**

Section 77-1-501, MCA, requires the Department to provide the Department of Revenue with a statement identifying each county where state property generating grazing, agricultural, or forest income exceeds six percent of the county's total land area. In addition to reporting the total acres owned in each county, the

## Findings and Recommendations

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statement must list the acres separately as grazing, agricultural, or forest land. The Department reported only the total acres owned in each county to the Department of Revenue since the implementation of Chapter 574, Laws of 2001. While this legislation did not modify the reporting requirement established in section 77-1-501, MCA, Department personnel believed the Department of Revenue no longer needed the information. However, the Department of Revenue subsequently notified the Department that state law still requires submission of the information.

### **Recommendation #11**

**We recommend the Department report grazing, agricultural and forestland acreage to the Department of Revenue as required by state law.**

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### **Surface and Ground Water Rights**

**The Department did not process surface and ground water rights applications in a timely manner.**

Sections 85-2-309 and 85-2-310, MCA, provide for an application process to establish surface and ground water rights. When the Department receives an objection to an application, it is required to hold a contested case hearing within 60 days. It must also grant, deny, or condition the application within 180 days of its last publication of notice of application. If no objections are received, the Department has 120 days to finalize the application.

During the audit, we noted one instance where a contested case hearing was held 577 days after objections were received. In addition, six applications having objections took between 301 to 621 days to finalize. We identified four applications, with no objections, that took between 137 and 370 days to finalize. Department personnel indicated they have difficulty meeting the application processing deadlines established in state law due to the volume of objections received and the need to gather additional information from the applicant. According to Department personnel, the volume

## Findings and Recommendations

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of objections is a result of the limited water resources currently available in the state. In addition, the Department had only one administrative law judge available for the hearings for the past several years. Department personnel stated that a second administrative law judge was added to the staff in July 2004.

The processing deadlines established in state law commit to the public that applications will be processed in a timely manner. If the Department believes the timeframes established in state law unreasonably restrict its ability to properly manage water rights, the Department can consider seeking legislation to balance the public's need for timely processing with the Department's need to properly fulfill its responsibilities in regard to water rights.

### **Recommendation #12**

**We recommend the Department process surface and ground water rights applications in the timeframes required by state law.**

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### **State Water Reservations**

**The Department did not review state water reservations.**

Section 85-2-316, MCA, requires the Department to periodically, at least every 10 years, review existing state water reservations to ensure the objectives of the reservations are being met. A water reservation can provide for existing or future beneficial uses or to maintain a minimum flow, level, or quality of water for a designated period of time. We determined the Department is not reviewing the reservations as required by state law. The Missouri River and Little Missouri River reservations were established in July 1992 and December 1994, respectively, but have yet to be reviewed. The Yellowstone River reservation was established in May 1988 and received a ten-year review in 1998, but the related report was not completed until May 2004. According to department personnel, the Yellowstone River reservation review was not completed until May 2004 due to a reduction in staff. The other reservation reviews have not occurred because the duties were not assigned to an employee.

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## Findings and Recommendations

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The Department should establish procedures to ensure state water reservation reviews are completed as required by state law.

### **Recommendation #13**

**We recommend the Department review state water reservations as required by state law.**

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### **Fire Protection Services Assessment**

**The Department did not provide fire protection services assessment information to the Department of Revenue or county treasurers in the timeframe required by state law.**

Fire protection assessment revenues finance one-third of the forestry division's base operating costs. Section 76-13-207, MCA, requires the Department to submit landowner information pertinent to the assessment to the Department of Revenue by the second Tuesday in August. In fiscal year 2003-04, the certification was submitted to the county treasurers and the Department of Revenue on or about September 16, 2003, but was due August 12, 2003. Department personnel indicated that the deadline established in law is difficult to meet, especially during a property reappraisal year. Department personnel also indicated most counties do not need the information until October. Department of Revenue personnel confirmed that the assessment information is provided to the counties before they need it. If the Department believes the submission deadline set in state law restricts its ability to accurately prepare the assessment information, the Department can consider seeking legislation to modify the deadline.

### **Recommendation #14**

**We recommend the Department submit fire cost protection assessment information by the deadline established in state law.**

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### **Schedule of Expenditures of Federal Awards**

**The Department did not accurately prepare its Schedule of Expenditures of Federal Awards or prepare its subgrant schedule.**

## Findings and Recommendations

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The Single Audit Act Amendments of 1996 and OMB Circular A-133 require the state to prepare financial reports related to its administration of federal awards. These reports are submitted to federal grantor agencies through the Single Audit Report, which the Office of Budget and Program Planning (OBPP) compiles. To meet this reporting requirement, OBPP requires each agency to submit a Schedule of Expenditures of Federal Awards (SEFA) and summary of subgrants made to non-state entities.

During the audit, we noted errors in the information submitted to OBPP. Expenditures reported on the fiscal year 2002-03 SEFA were overstated by a total of \$5,330,442 for two federal awards. Expenditures reported on the fiscal year 2003-04 SEFA were overstated by \$11,420,268 for one federal award. In addition, department personnel did not prepare or submit a summary of the \$1,819,722 and \$3,051,743 in subgrants made to non-state entities during fiscal years 2002-03 and 2003-04, respectively, until we discussed the requirement with them. We addressed a similar issue in the prior audit report. The Department should establish procedures to verify the completeness and accuracy of the information before it is provided to OBPP. The commingled expenditures on the financial records issue (page 10) contributes to this issue and must also be addressed to ensure the completeness and accuracy of the SEFA and subgrant schedule.

### **Recommendation #15**

**We recommend the Department establish procedures to ensure its annual Schedule of Expenditures of Federal Awards and summary of subgrant activity are complete and contain accurate information as required by OMB Circular A-133 and the Single Audit Act Amendments of 1996.**

# **Independent Auditor's Report & Department Financial Schedules**

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# LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor  
John W. Northey, Legal Counsel



Deputy Legislative Auditors:  
Jim Pellegrini, Performance Audit  
Tori Hunthausen, IS Audit & Operations  
James Gillett, Financial-Compliance Audit

## INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee  
of the Montana State Legislature:

We have audited the accompanying Schedules of Changes in Fund Balances & Property Held in Trust, Schedules of Total Revenues & Transfers-In, and Schedules of Total Expenditures & Transfers-Out of the Department of Natural Resources and Conservation for each of the fiscal years ended June 30, 2004, and 2003. The information contained in these financial schedules is the responsibility of the Department's management. Our responsibility is to express an opinion on these financial schedules based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial schedules are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial schedules. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial schedule presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in note 1, the financial schedules are presented on a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The schedules are not intended to be a complete presentation and disclosure of the Department's assets, liabilities and cash flows.

The Department made errors in recording expenditures and revenues in the Permanent Fund in fiscal year 2003-04. Prior Year Revenues & Transfers-In Adjustments are understated and Nonbudgeted Revenues & Transfers-In are overstated by \$40,374,975 on the Schedules of Changes in Fund Balances & Property Held in Trust and Total Revenues & Transfers-In. Prior Year Expenditures & Transfers-Out Adjustments are understated and Nonbudgeted Expenditures & Transfers-Out are overstated by \$40,374,975 on the Schedule of Changes in Fund Balances & Property Held in Trust and in the Forestry Program on the Schedule of Total Expenditures & Transfers-Out.



The Department also made errors in recording revenue estimates in the Permanent and Debt Service Funds. On the Schedule of Total Revenue & Transfers-In, Permanent Fund Estimated Revenues & Transfers-In are understated and Budgeted Revenues & Transfers-In Over Estimated are overstated by \$42,532,400. Permanent Fund Budgeted Revenues & Transfers-In Over Estimated by Class are overstated as follows: Licenses & Permits by \$362,000; Charges for Services by \$15,000; Investment Earnings by \$100; Sale of Documents, Merchandise and Property by \$9,154,000; and Rentals, Leases and Royalties by \$33,001,300. Debt Service Fund Estimated Revenues & Transfers-In are understated and Budgeted Revenues & Transfers-In Over Estimated are overstated by \$731,800. Debt Service Fund Budgeted Revenues & Transfers-In Over Estimated by Class – Investment Earnings are overstated by \$731,800.

In our opinion, except for the effects of the errors in recording revenues, expenditures, and revenue estimates as discussed in the preceding paragraphs, the financial schedules referred to above present fairly, in all material respects, the results of operations and changes in fund balances and property held in trust of the Department of Natural Resources and Conservation for each of the fiscal years ended June 30, 2004, and 2003, in conformity with the basis of accounting described in note 1.

Respectfully submitted,

*(Signature on File)*

James Gillett, CPA  
Deputy Legislative Auditor

September 10, 2004

DEPARTMENT OF NATURAL RESOURCE & CONSERVATION  
SCHEDULE OF CHANGES IN FUND BALANCES & PROPERTY HELD IN TRUST  
FOR THE FISCAL YEAR ENDED JUNE 30, 2004

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Debt Service Fund	Internal Service Fund	Agency Fund	Permanent Fund
FUND BALANCE: July 1, 2003	\$ (1,686,429)	\$ 145,671,111	\$ (413,894)	\$ 42,824,694	\$ 157,461		\$ 455,977,095
PROPERTY HELD IN TRUST: July 1, 2003						\$ 2,739,415	
ADDITIONS							
Budgeted Revenues & Transfers-In	284,794	99,476,609	35,210,667		1,046,001		
Nonbudgeted Revenues & Transfers-In	56,605	71,980,607		17,189,314	412		96,102,337
Prior Year Revenues & Transfers-In Adjustments	152,498	33,145	34,660	(77,689)	8,702		(40,176,069)
Direct Entries to Fund Balance	16,410,257	(41,202,451)	30,024,869	323,718			17,623
Additions to Property Held in Trust						1,508,933	
Total Additions	16,904,154	130,287,910	65,270,196	17,435,343	1,055,115	1,508,933	55,943,891
REDUCTIONS							
Budgeted Expenditures & Transfers-Out	16,862,361	19,473,879	80,342,211		1,098,125		
Nonbudgeted Expenditures & Transfers-Out	5,325	75,954,525		16,853,188	31,317		115,586,899
Prior Year Expenditures & Transfers-Out Adjustments	25,012	1,913,838	(25,466)	2,930	(15,893)		(40,374,975)
Reductions in Property Held in Trust						2,138,403	
Total Reductions	16,892,698	97,342,242	80,316,745	16,856,118	1,113,549	2,138,403	75,211,924
FUND BALANCE: June 30, 2004	\$ (1,674,973)	\$ 178,616,779	\$ (15,460,443)	\$ 43,403,919	\$ 99,027		\$ 436,709,062
PROPERTY HELD IN TRUST: June 30, 2004						\$ 2,109,945	

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

DEPARTMENT OF NATURAL RESOURCES & CONSERVATION  
SCHEDULE OF CHANGES IN FUND BALANCES & PROPERTY HELD IN TRUST  
FOR THE FISCAL YEAR ENDED JUNE 30, 2003

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Debt Service Fund	Internal Service Fund	Agency Fund	Permanent Fund
FUND BALANCE: July 1, 2002	\$ (2,215,037)	\$ 105,346,564	\$ (76,596)	\$ 53,153,894	\$ 175,687		\$ 423,729,043
PROPERTY HELD IN TRUST: July 1, 2002						\$ 2,025,597	
ADDITIONS							
Budgeted Revenues & Transfers-In	266,354	75,744,586	11,176,508		802,524		
Nonbudgeted Revenues & Transfers-In	42,829	88,847,269		15,092,628			150,773,126
Prior Year Revenues & Transfers-In Adjustments	77,949	(188,656)	(907,584)	443,602	4,228		455
Direct Entries to Fund Balance	19,926,659	(35,336,923)	148,678	(4,226,266)			73,810
Additions to Property Held in Trust						2,334,646	
Total Additions	20,313,791	129,066,276	10,417,602	11,309,964	806,752	2,334,646	150,847,391
REDUCTIONS							
Budgeted Expenditures & Transfers-Out	16,996,734	27,448,727	10,796,919		850,146		
Nonbudgeted Expenditures & Transfers-Out		64,203,708		17,169,154	21,040		118,870,129
Prior Year Expenditures & Transfers-Out Adjustments	2,788,449	(2,910,706)	(42,019)	4,470,010	(46,208)		(270,790)
Reductions in Property Held in Trust						1,620,828	
Total Reductions	19,785,183	88,741,729	10,754,900	21,639,164	824,978	1,620,828	118,599,339
FUND BALANCE: June 30, 2003	\$ (1,686,429)	\$ 145,671,111	\$ (413,894)	\$ 42,824,694	\$ 157,461		\$ 455,977,095
PROPERTY HELD IN TRUST: June 30, 2003						\$ 2,739,415	

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment.  
Additional information is provided in the notes to the financial schedules beginning on page A-11.

DEPARTMENT OF NATURAL RESOURCE & CONSERVATION  
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN  
FOR THE FISCAL YEAR ENDED JUNE 30, 2004

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Debt Service Fund	Internal Service Fund	Permanent Fund	Total
<b>TOTAL REVENUES &amp; TRANSFERS-IN BY CLASS</b>							
Licenses and Permits	\$ 1,691	\$ 312,916				\$ 538,781	\$ 853,388
Taxes	11,034	2,405,776	\$ 797		\$ 212		2,417,819
Charges for Services	359,034	3,855,400	31,749,746	\$ 5,766	618,585		36,588,531
Investment Earnings		2,721,161	584	6,660,961		6,694,106	16,076,812
Fines, Forfeits and Settlements	13,100	80,000					93,100
Sale of Documents, Merchandise and Property	1,585	891,109		2,081,782		11,141,032	14,115,508
Rentals, Leases and Royalties	18,418	80,504				31,057,769	31,156,691
Miscellaneous	8,857	19,768			200		28,825
Grants, Contracts, Donations and Abandonments		510,253	(3,484)				506,769
Other Financing Sources		160,613,474		8,363,116	436,118	6,494,580	175,907,288
Federal	80,178		3,315,545				3,395,723
Federal Indirect Cost Recoveries			182,139				182,139
Total Revenues & Transfers-In	493,897	171,490,361	35,245,327	17,111,625	1,055,115	55,926,268	281,322,593
Less: Nonbudgeted Revenues & Transfers-In	56,605	71,980,607		17,189,314	412	96,102,337	185,329,275
Prior Year Revenues & Transfers-In Adjustments	152,498	33,145	34,660	(77,689)	8,702	(40,176,069)	(40,024,753)
Actual Budgeted Revenues & Transfers-In	284,794	99,476,609	35,210,667	0	1,046,001	0	136,018,071
Estimated Revenues & Transfers-In	377,100	62,742,210	9,308,477	(731,800)	860,000	(42,532,400)	30,023,587
Budgeted Revenues & Transfers-In Over (Under) Estimated	\$ (92,306)	\$ 36,734,399	\$ 25,902,190	\$ 731,800	\$ 186,001	\$ 42,532,400	\$ 105,994,484
<b>BUDGETED REVENUES &amp; TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS</b>							
Licenses and Permits		\$ 28,616				\$ 362,000	\$ 390,616
Taxes		(147,339)					(147,339)
Charges for Services	\$ 157,409	726,458	\$ 30,649,747		\$ 149,883	15,000	31,698,497
Investment Earnings		1,010,877	(1,516)	\$ 731,800		100	1,741,261
Fines, Forfeits and Settlements	12,350	(65,000)					(52,650)
Sale of Documents, Merchandise and Property	(25)	(3,621,839)				9,154,000	5,532,136
Rentals, Leases and Royalties	(40)	994,083				33,001,300	33,995,343
Miscellaneous		4,874					4,874
Grants, Contracts, Donations and Abandonments		(387,310)					(387,310)
Other Financing Sources		38,190,979			36,118		38,227,097
Federal	(262,000)		(4,795,086)				(5,057,086)
Federal Indirect Cost Recoveries			49,045				49,045
Budgeted Revenues & Transfers-In Over (Under) Estimated	\$ (92,306)	\$ 36,734,399	\$ 25,902,190	\$ 731,800	\$ 186,001	\$ 42,532,400	\$ 105,994,484

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

DEPARTMENT OF NATURAL RESOURCES & CONSERVATION  
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN  
FOR THE FISCAL YEAR ENDED JUNE 30, 2003

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Debt Service Fund	Internal Service Fund	Permanent Fund	Total
<b>TOTAL REVENUES &amp; TRANSFERS-IN BY CLASS</b>							
Licenses and Permits	\$ 7,009	\$ 261,660	\$ (16,649)			\$ 545,182	\$ 797,202
Taxes	4,687	2,404,299	64				2,409,050
Charges for Services	348,920	2,982,082	4,607,885	\$ 11,015	\$ 417,582		8,367,484
Investment Earnings		2,153,265	2,121	6,625,716		59,044,469	67,825,571
Fines and Forfeits	2,689	53,755					56,444
Sale of Documents, Merchandise and Property	700	3,343,532		2,514,041		4,687,749	10,546,022
Rentals, Leases and Royalties	13,341	46,600				27,645,514	27,705,455
Miscellaneous	6,186	15,776					21,962
Grants, Contracts, Donations and Abandonments	3,600	1,373,331					1,376,931
Other Financing Sources		151,768,899		6,385,458	389,170	58,850,667	217,394,194
Federal			5,548,693				5,548,693
Federal Indirect Cost Recoveries			126,810				126,810
Total Revenues & Transfers-In	<u>387,132</u>	<u>164,403,199</u>	<u>10,268,924</u>	<u>15,536,230</u>	<u>806,752</u>	<u>150,773,581</u>	<u>342,175,818</u>
Less: Nonbudgeted Revenues & Transfers-In	42,829	88,847,269		15,092,628		150,773,126	254,755,852
Prior Year Revenues & Transfers-In Adjustments	<u>77,949</u>	<u>(188,656)</u>	<u>(907,584)</u>	<u>443,602</u>	<u>4,228</u>	<u>455</u>	<u>(570,006)</u>
Actual Budgeted Revenues & Transfers-In	<u>266,354</u>	<u>75,744,586</u>	<u>11,176,508</u>	<u>0</u>	<u>802,524</u>	<u>0</u>	<u>87,989,972</u>
Estimated Revenues & Transfers-In	<u>409,340</u>	<u>86,375,044</u>	<u>6,928,505</u>	<u>0</u>	<u>944,974</u>	<u>0</u>	<u>94,657,863</u>
Budgeted Revenues & Transfers-In Over (Under) Estimated	<u>\$ (142,986)</u>	<u>\$ (10,630,458)</u>	<u>\$ 4,248,003</u>	<u>\$ 0</u>	<u>\$ (142,450)</u>	<u>\$ 0</u>	<u>\$ (6,667,891)</u>
<b>BUDGETED REVENUES &amp; TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS</b>							
Licenses and Permits		\$ 27,660	\$ (33,649)				\$ (5,989)
Taxes		94,842					94,842
Charges for Services	\$ (135,040)	(976,474)	4,607,885		\$ (176,200)		3,320,171
Investment Earnings		(1,331,272)	(7,879)				(1,339,151)
Fines and Forfeits	(7,896)	13,755					5,859
Sale of Documents, Merchandise and Property		323,823					323,823
Rentals, Leases and Royalties	(50)						(50)
Miscellaneous		211					211
Grants, Contracts, Donations and Abandonments		(4,806)	(15,000)				(19,806)
Other Financing Sources		(8,778,197)			33,750		(8,744,447)
Federal			(364,965)				(364,965)
Federal Indirect Cost Recoveries			61,611				61,611
Budgeted Revenues & Transfers-In Over (Under) Estimated	<u>\$ (142,986)</u>	<u>\$ (10,630,458)</u>	<u>\$ 4,248,003</u>	<u>\$ 0</u>	<u>\$ (142,450)</u>	<u>\$ 0</u>	<u>\$ (6,667,891)</u>

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

DEPARTMENT OF NATURAL RESOURCE & CONSERVATION  
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT  
FOR THE FISCAL YEAR ENDED JUNE 30, 2004

PROGRAM (ORG) EXPENDITURES & TRANSFERS-OUT	CENTRALIZED SERVICES	CONSERVATION/RESOURCE DEVELOPMENT DIVISION	FORESTRY	OIL & GAS CONSERVATION DIVISION	RESERVED WATER RIGHTS COMPACT COMMISSION	WATER RESOURCES DIVISION	TOTAL
Personal Services							
Salaries	\$ 1,436,097	\$ 922,207	\$ 10,168,637	\$ 659,852	\$ 416,204	\$ 4,180,411	\$ 17,783,409
Hourly Wages			5,222,671				5,222,670
Other Compensation		530	1,319	4,500	4,830	350	11,529
Employee Benefits	369,643	258,678	3,548,288	191,293	109,699	1,201,072	5,678,673
Personal Services-Other			8,631				8,631
Total	<u>1,805,740</u>	<u>1,181,415</u>	<u>18,949,546</u>	<u>855,645</u>	<u>530,733</u>	<u>5,381,833</u>	<u>28,704,912</u>
Operating Expenses							
Other Services	283,963	1,014,109	52,690,932	612,048	25,266	2,088,351	56,714,669
Supplies & Materials	69,124	47,885	3,382,473	40,744	24,415	275,701	3,840,342
Communications	55,172	31,319	415,473	42,019	7,394	127,947	679,324
Travel	12,978	79,873	547,580	30,663	21,510	104,175	796,779
Rent	159,127	60,970	16,382,335	14,689	38,216	404,528	17,059,865
Utilities	17,948	4,907	206,832	13,232	4,319	6,608	253,846
Repair & Maintenance	1,462	8,854	1,185,020	20,069	1,569	44,014	1,260,988
Other Expenses	13,121	488,437	386,220	20,936	9,681	105,437	1,023,832
Goods Purchased For Resale			393				393
Total	<u>612,895</u>	<u>1,736,354</u>	<u>75,197,258</u>	<u>794,400</u>	<u>132,370</u>	<u>3,156,761</u>	<u>81,630,038</u>
Equipment & Intangible Assets							
Equipment	12,199	24,404	665,820	38,307		5,772	746,502
Capital Leases-Equipment-Nonbu			5,325				5,325
Total	<u>12,199</u>	<u>24,404</u>	<u>671,145</u>	<u>38,307</u>		<u>5,772</u>	<u>751,827</u>
Capital Outlay							
Land & Interest In Land						2,726,862	2,726,862
Buildings						75	75
Total						<u>2,726,937</u>	<u>2,726,937</u>
Local Assistance							
From State Sources		213,373					213,373
Total		<u>213,373</u>					<u>213,373</u>
Grants							
From State Sources		1,240,890					1,240,890
From Federal Sources			3,051,742				3,051,742
Total		<u>1,240,890</u>	<u>3,051,742</u>				<u>4,292,632</u>
Benefits & Claims							
To Individuals		1,000,000					1,000,000
Total		<u>1,000,000</u>					<u>1,000,000</u>
Transfers							
Accounting Entity Transfers	37,779	79,267,214	76,285,274				155,590,267
Intra-Entity Expense			2,783,563				2,783,563
Total	<u>37,779</u>	<u>79,267,214</u>	<u>79,068,837</u>				<u>158,373,830</u>
Debt Service							
Bonds		9,592,753					9,592,753
Loans		23,843	6,505			394,895	425,243
Capital Leases	3,345		18,386				21,731
Total	<u>3,345</u>	<u>9,616,596</u>	<u>24,891</u>			<u>394,895</u>	<u>10,039,727</u>
Total Expenditures & Transfers-Out	<u>\$ 2,471,958</u>	<u>\$ 94,280,246</u>	<u>\$ 176,963,419</u>	<u>\$ 1,688,352</u>	<u>\$ 663,103</u>	<u>\$ 11,666,198</u>	<u>\$ 287,733,276</u>
EXPENDITURES & TRANSFERS-OUT BY FUND							
General Fund	\$ 1,856,211	\$ 2,305,871	\$ 6,205,732		\$ 663,103	\$ 5,861,781	\$ 16,892,698
State Special Revenue Fund	530,133	74,682,609	15,149,187	\$ 1,581,470		5,398,843	97,342,242
Federal Special Revenue Fund	85,614	441,503	79,283,027	106,882		399,719	80,316,745
Debt Service Fund		16,850,263				5,855	16,856,118
Internal Service Fund			1,113,549				1,113,549
Permanent Fund			75,211,924				75,211,924
Total Expenditures & Transfers-Out	<u>2,471,958</u>	<u>94,280,246</u>	<u>176,963,419</u>	<u>1,688,352</u>	<u>663,103</u>	<u>11,666,198</u>	<u>287,733,276</u>
Less: Nonbudgeted Expenditures & Transfers-Out		89,322,000	119,089,436			19,819	208,431,255
Prior Year Expenditures & Transfers-Out Adjustments	(939)	(138,102)	(40,418,395)	2,380	(1,345)	2,081,846	(38,474,555)
Actual Budgeted Expenditures & Transfers-Out	<u>2,472,897</u>	<u>5,096,348</u>	<u>98,292,378</u>	<u>1,685,972</u>	<u>664,448</u>	<u>9,564,533</u>	<u>117,776,576</u>
Budget Authority	<u>2,943,954</u>	<u>13,132,871</u>	<u>102,467,683</u>	<u>2,800,746</u>	<u>664,662</u>	<u>12,960,490</u>	<u>134,970,406</u>
Unspent Budget Authority	<u>\$ 471,057</u>	<u>\$ 8,036,523</u>	<u>\$ 4,175,305</u>	<u>\$ 1,114,774</u>	<u>\$ 214</u>	<u>\$ 3,395,958</u>	<u>\$ 17,193,830</u>
UNSPENT BUDGET AUTHORITY BY FUND							
General Fund	\$ 38,742	\$ 3,384	\$ 138,879		\$ 214	\$ 51,019	\$ 232,238
State Special Revenue Fund	399,628	7,993,218	758,320	\$ 1,111,656		3,160,760	13,423,582
Federal Special Revenue Fund	32,687	39,921	3,162,770	3,118		184,178	3,422,674
Internal Service Fund			115,336				115,336
Unspent Budget Authority	<u>\$ 471,057</u>	<u>\$ 8,036,523</u>	<u>\$ 4,175,305</u>	<u>\$ 1,114,774</u>	<u>\$ 214</u>	<u>\$ 3,395,958</u>	<u>\$ 17,193,830</u>

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

DEPARTMENT OF NATURAL RESOURCES & CONSERVATION  
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT  
FOR THE FISCAL YEAR ENDED JUNE 30, 2003

PROGRAM (ORG) EXPENDITURES & TRANSFERS-OUT	CENTRALIZED SERVICES	CONSERVATION & RESOURCE DEVELOPMENT DIVISION	FORESTRY	OIL & GAS CONSERVATION DIVISION	RESERVED WATER RIGHTS COMPACT COMMISSION	WATER RESOURCES DIVISION	TOTAL
Personal Services							
Salaries	\$ 1,444,768	\$ 857,369	\$ 8,828,467	\$ 603,613	\$ 466,548	\$ 4,302,763	\$ 16,503,528
Hourly Wages			3,089,110				3,089,110
Other Compensation		574		5,099	3,004	200	8,877
Employee Benefits	351,123	229,292	2,869,271	166,429	114,045	1,135,299	4,865,459
Personal Services-Other			(14,424)				(14,424)
Total	<u>1,795,891</u>	<u>1,087,235</u>	<u>14,772,424</u>	<u>775,141</u>	<u>583,597</u>	<u>5,438,262</u>	<u>24,452,550</u>
Operating Expenses							
Other Services	230,135	800,615	5,965,511	880,133	22,535	4,681,185	12,580,114
Supplies & Materials	59,953	28,158	1,756,075	32,182	25,311	168,707	2,070,386
Communications	41,246	33,404	315,348	41,405	8,017	125,567	564,987
Travel	11,091	55,959	322,891	31,759	13,800	64,039	499,539
Rent	153,297	62,541	2,042,614	18,418	35,173	489,095	2,801,138
Utilities	15,378	3,733	141,863	11,120	3,733	8,355	184,182
Repair & Maintenance	6,222	4,406	658,808	15,173	3,324	18,753	706,686
Other Expenses	22,831	114,727	374,511	25,106	4,556	119,369	661,100
Total	<u>540,153</u>	<u>1,103,543</u>	<u>11,577,621</u>	<u>1,055,296</u>	<u>116,449</u>	<u>5,675,070</u>	<u>20,068,132</u>
Equipment & Intangible Assets							
Equipment	9,218		450,663	26,094	10,500		496,475
Total	<u>9,218</u>		<u>450,663</u>	<u>26,094</u>	<u>10,500</u>		<u>496,475</u>
Capital Outlay							
Land & Interest In Land			119			(2,726,862)	(2,726,743)
Total			<u>119</u>			<u>(2,726,862)</u>	<u>(2,726,743)</u>
Local Assistance							
From State Sources		221,002					221,002
Total		<u>221,002</u>					<u>221,002</u>
Grants							
From State Sources		7,554,179	1,819,722				9,373,901
From Federal Sources						4,653	4,653
From Other Sources		(29,663)				44,483	14,820
Total		<u>7,524,516</u>	<u>1,819,722</u>			<u>49,136</u>	<u>9,393,374</u>
Benefits & Claims							
To Individuals		500,000					500,000
Other Financing Uses/Deduction		979,943					979,943
Total		<u>1,479,943</u>					<u>1,479,943</u>
Transfers							
Accounting Entity Transfers		76,198,576	120,117,419			61,862	196,377,857
Total		<u>76,198,576</u>	<u>120,117,419</u>			<u>61,862</u>	<u>196,377,857</u>
Debt Service							
Bonds		10,052,691					10,052,691
Loans		17,805	101,000			411,975	530,780
Capital Leases	3,087		13,395				16,482
Lease Participation Notes		(17,250)					(17,250)
Total	<u>3,087</u>	<u>10,053,246</u>	<u>114,395</u>			<u>411,975</u>	<u>10,582,703</u>
Total Expenditures & Transfers-Out	<u>\$ 2,348,349</u>	<u>\$ 97,668,061</u>	<u>\$ 148,852,363</u>	<u>\$ 1,856,531</u>	<u>\$ 710,546</u>	<u>\$ 8,909,443</u>	<u>\$ 260,345,293</u>
EXPENDITURES & TRANSFERS-OUT BY FUND							
General Fund	\$ 1,667,938	\$ 1,003,059	\$ 10,289,982		\$ 706,946	\$ 6,117,258	\$ 19,785,183
State Special Revenue Fund	556,799	72,689,863	11,346,129	\$ 1,749,411	3,600	2,395,927	88,741,729
Federal Special Revenue Fund	123,612	161,173	9,969,675	107,120		393,320	10,754,900
Debt Service Fund		21,636,226				2,938	21,639,164
Internal Service Fund			824,978				824,978
Permanent Fund		2,177,740	116,421,599				118,599,339
Total Expenditures & Transfers-Out	<u>2,348,349</u>	<u>97,668,061</u>	<u>148,852,363</u>	<u>1,856,531</u>	<u>710,546</u>	<u>8,909,443</u>	<u>260,345,293</u>
Less: Nonbudgeted Expenditures & Transfers-Out		82,643,409	120,074,599			(2,453,977)	200,264,031
Prior Year Expenditures & Transfers-Out Adjustments	1,001	4,126,698	(164,123)	(602)	(734)	26,496	3,988,736
Actual Budgeted Expenditures & Transfers-Out	<u>2,347,348</u>	<u>10,897,954</u>	<u>28,941,887</u>	<u>1,857,133</u>	<u>711,280</u>	<u>11,336,924</u>	<u>56,092,526</u>
Budget Authority	2,512,362	12,598,197	104,173,973	2,339,745	751,119	14,070,955	136,446,351
Unspent Budget Authority	<u>\$ 165,014</u>	<u>\$ 1,700,243</u>	<u>\$ 75,232,086</u>	<u>\$ 482,612</u>	<u>\$ 39,839</u>	<u>\$ 2,734,031</u>	<u>\$ 80,353,825</u>
UNSPENT BUDGET AUTHORITY BY FUND							
General Fund	\$ 80,009	\$ 93,973	\$ 358,184		\$ 39,839	\$ 67,034	\$ 639,039
State Special Revenue Fund	82,446	1,606,017	73,017,931	\$ 479,732		2,294,368	77,480,494
Federal Special Revenue Fund	2,559	253	1,707,356	2,880		372,629	2,085,677
Internal Service Fund			148,615				148,615
Unspent Budget Authority	<u>\$ 165,014</u>	<u>\$ 1,700,243</u>	<u>\$ 75,232,086</u>	<u>\$ 482,612</u>	<u>\$ 39,839</u>	<u>\$ 2,734,031</u>	<u>\$ 80,353,825</u>

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

# Department of Natural Resources and Conservation

## Notes to the Financial Schedules

### For the Two Fiscal Years Ended June 30, 2004

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#### 1. Summary of Significant Accounting Policies

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##### **Basis of Accounting**

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The Department uses the modified accrual basis of accounting, as defined by state accounting policy, for its Governmental fund category (General, State Special Revenue, Federal Special Revenue, Debt Service and Permanent). In applying the modified accrual basis, the Department records:

Revenues when it receives cash or when receipts are measurable and available to pay current period liabilities.

Expenditures for valid obligations when the Department incurs the related liability and it is measurable, with the exception of the cost of employees' annual and sick leave. State accounting policy requires the Department to record the cost of employees' annual leave and sick leave when used or paid.

The Department uses accrual basis accounting for its Proprietary (Internal Service) and Fiduciary (Agency) fund categories. Under the accrual basis, as defined by state accounting policy, the Department records revenues in the accounting period earned, when measurable, and records expenses in the period incurred, when measurable.

Expenditures and expenses may include: entire budgeted service contracts even though the Department receives the services in a subsequent fiscal year; goods ordered with a purchase order before fiscal year-end, but not received as of fiscal year-end; and equipment ordered with a purchase order before fiscal year-end.

##### **Basis of Presentation**

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The financial schedule format is in accordance with the policy of the Legislative Audit Committee. The financial schedules are prepared



## Notes to the Financial Schedules

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from the transactions posted to the state's accounting system without adjustment.

Department accounts are organized in funds according to state law applicable at the time transactions were recorded. The Department uses the following funds:

### **Governmental Fund Category**

**General Fund** – to account for all financial resources except those required to be accounted for in another fund.

**State Special Revenue Fund** – to account for proceeds of specific revenue sources that are legally restricted to expenditures for specific purposes. The Department has several State Special Revenue Funds that account for activities. These include Forestry operations, Wastewater and Drinking Water Projects, and the Renewable Resource Grants and Loans Program.

**Federal Special Revenue Fund** – to account for federal funds received by the Department. The Department's fire operations and suppression efforts are financed in part by federal funds.

**Debt Service Fund** – to account for accumulated resources for the payment of general long-term debt principal and interest. The Department uses this fund for the bonds issued to provide funding for Renewable Resources, Coal Severance Tax, and water development projects.

**Permanent Fund** – to account for financial resources that are legally restricted to the extent that only earnings, and not principal, may be used for purposes that support the Department's programs. The Department uses this fund for the Common School Permanent Trust, University and College Trusts, Morrill Permanent Trust, Deaf and Blind Permanent Trust, Pine Hills School Permanent Trust, Capitol Building Trust, and the Trust and Legacy Account.

### **Proprietary Fund Category**

**Internal Service Fund** – to account for the financing of goods or services provided by one department or agency to other departments

## Notes to the Financial Schedules

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or agencies of state government or to other governmental entities on a cost-reimbursement basis. The Department's Internal Service Fund contains the Forestry Division's Air Operations Bureau. The Air Operations Bureau maintains and operates aircraft to aid in fire suppression.

### **Fiduciary Fund Category**

**Agency Fund** – to account for resources held by the state in a custodial capacity. The Department Agency Funds account for activity such as protested oil and gas royalties, non-land grant interest and income, and hazard reduction.

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### **2. General Fund Balance**

The negative fund balances in the General Fund do not indicate overspent appropriation authority. The Department has authority to pay obligations from the statewide General Fund within its appropriation limits. The Department expends cash or other assets from the statewide fund when it pays General Fund obligations. The Department's outstanding liabilities exceed the assets it placed in the fund, resulting in negative ending General Fund balances for the fiscal years ended June 30, 2003, and June 30, 2004.

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### **3. Direct Entries to Fund Balance**

Direct entries to fund balances in the General, State Special Revenue, Federal Special Revenue, Debt Service and Permanent Funds include entries generated by SABHRS to reflect the flow of resources within individual funds shared by separate agencies.

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### **4. Long-Term Debt**

During fiscal year 2002-03, the state of Montana issued General Obligation Renewable Resource Program Refunding 2003 Series C bonds for \$1,970,000. Proceeds of \$1,000,000 were used to fund loans under the state's renewable resource program. The remaining proceeds of \$915,000 were used to refund the General Obligation Water Development Bonds, 1991 Series A, and the General Obligation Renewable Resource Program Bonds, 1996 Series B and 1996 Series E. The state of Montana issued 2003 Series D bonds for \$2,730,000 and 2003 Series E bonds for \$1,675,000 for water project loans. During fiscal year 2003-04, the state issued 2004 Series A General Obligation bonds of \$2,665,000 to finance loans under the Water Pollution Control State Revolving Fund Program. At June 30,

## Notes to the Financial Schedules

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2004, the Department had a total of \$32,622,176 in General Obligation bonds outstanding.

The Department issued Coal Severance Tax (CST) 2003 Series A bonds for \$3,000,000. These bonds were issued to fund loans to private water user groups and associations for water projects. These loans can be made to political subdivisions within the state to finance water and wastewater products. The loans can also be used to finance improvements to state-owned dams. At June 30, 2004, the Department had a total of \$43,015,000 of CST bonds outstanding.

The Department has a loan from the U.S. Bureau of Reclamation to fund the Middle Creek Dam project. The unpaid loan principal as of June 30, 2004, was \$2,687,278.

The Northern Cheyenne Tribe and the Department entered into an agreement on July 1, 1994, in which the tribe agreed to loan the state up to \$11,500,000 of federal funds appropriated as part of the Northern Cheyenne Indian Reserved Water Rights Settlement. The non-interest bearing loan was used to help finance the costs of the Tongue River Dam Project. The actual amount of the loan was \$11,300,000. The outstanding loan balance at June 30, 2004, was \$9,851,282. In March 2004, the Department issued a Coal Severance Tax 2004 Series A bond to the tribe for \$9,851,282 as security for the loan. The bond, which is non-interest bearing, provides a means of repayment to the tribe in the event pledged revenues are insufficient for loan repayment.

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### 5. Other Financing Sources

The Schedules of Total Revenues and Transfers-In contain substantial activity in the other financing sources class.

**State Special Revenue Fund** – A portion of this activity is the transfer of Common School Permanent Trust Fund earnings to the Guarantee Account for distribution to school districts. Transfers-In activity also includes the movement of loans receivable from other funds and the transfer of federal funds from the Department of

## Notes to the Financial Schedules

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Environmental Quality for the Clean Water and Drinking Water State Revolving Funds.

**Debt Service Fund** – This activity is comprised of the movement of loans receivable from other funds.

**Permanent Fund** – This activity represents the allocation of interest and income within the trust funds administered by the Department

### 6. **Special Revenue Fund Unspent Budget Authority**

Chapter 418, Laws of 2001, authorized the Department to purchase mineral production rights held by the Public School Fund. Chapter 418, Laws of 2001, authorized a Coal Severance Tax loan and provided biennial appropriation authority of up to \$75 million to the Department to finance the purchase. The Department acquired the mineral royalty proceeds stream in fiscal year 2001-02 for approximately \$46 million through the use of a loan and the appropriation authority was not needed. As a result, the Schedule of Total Expenditures & Transfers Out for the fiscal year ended June 30, 2003, includes unspent budget authority of \$71,630,389 in the State Special Revenue Fund.

### 7. **Trust Land Management Division**

The Trust Land Management Division manages trust lands granted to the state of Montana by the Enabling Act of 1889. Division expenditures are reported as part of the Forestry program on the Schedules of Total Expenditures and Transfer-Out.

## **Department Response**

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**DNRC RESPONSE TO FY 03/04 LEGISLATIVE AUDIT****1) We recommend the Department:****A. Establish, document, and monitor internal control over compliance with requirements for the Cooperative Forestry Assistance federal award.**

Concur. DNRC will establish, document and monitor internal control over compliance with federal award requirements.

**B. Reimburse the United States Department of Agriculture \$6,878 for unallowable costs charged to the Cooperative Forestry Assistance federal award.**

Concur. The USDA/Cooperative Forestry Assistance federal award has been reimbursed for unallowable costs.

**2) We recommend the department clarify and enforce its policy regarding the review, approval, and processing of claims:**

Concur. DNRC will meet with program staff and clarify accounts payable procedures.

**3) We recommend the department establish procedures to verify the accuracy of recorded revenue estimates.**

Concur. DNRC is currently in the process of hiring another accountant to resolve the lack of resources. Procedures will be established to review revenue estimates prior to close of fiscal year.

**4) We recommend the department establish procedures to ensure distributions of unrealized investment income are properly classified on the states accounting records.**

Concur. DNRC staff will review unrealized investment account balances prior to close of fiscal year.

**5) We recommend the department review federal revenue accruals and deferrals for compliance with state accounting policy and process necessary correcting entries.**

Concur. DNRC will review federal revenue accruals and deferrals for compliance prior to close of fiscal year.

**6) We recommend the department establish procedures to ensure bond and note payables are properly classified on the state's accounting records.**

Concur. DNRC will establish fiscal year end procedures to ensure bond and note accounting entries are properly recorded.

- 7) **We recommend the department record infrastructure transactions in accordance with state accounting policy.**  
Concur. The department will establish procedures to ensure infrastructure is properly recorded.
- 8) **We recommend the department place Permanent Fund timber sale revenues in the state timber sale account as prescribed by law.**  
Concur. The department is currently funding the state timber sale account as prescribed by law
- 9) **We recommend the department take immediate measures to resolve the conflict in state law related to the use of Public School Fund mineral royalties and other permanent fund revenues to finance the cost of administering state trust land.**

Do Not Concur. The financial audit's review does not advise of any discrepancy between the department's implementation of, and the legislature's intent for, the funding of the trust land administration account, as enacted and codified at 77-1-108 and -109, MCA. At enactment, the legislature was aware of the viewpoint expressed in Recommendation #9. The legislature was also aware of the preponderance of case law, Montana Attorney General opinion, and fundamental tenants of trust law; all of which support the widely accepted ability of a trust manager to utilize a reasonable portion of gross revenue to cover management costs. This is not mentioned or challenged in the financial audit's review. All proceeds (the amount of revenue available after covering management costs) are placed into the appropriate trust. Trust beneficiary groups are active in Montana. The State and department has been the subject of past and current legal challenges to the constitutionality of various statutes, as well as aspects of the department's implementation of statute. These groups have not challenged the core premise embodied in 77-108 and -109, MCA; specifically that prudent trust management includes allocation of a portion of gross revenue to cover reasonable and necessary trust management costs. Actions of the legislature are constitutional unless determined otherwise in court.

- 10) **We recommend the department comply with state law by distributing Montana University System trust fund time revenues.**  
Concur. The department has advised the Montana University System of the audit recommendation.
- 11) **We recommend the department report grazing, agricultural and forestland acreage to the Department of Revenue as required by state law.**  
Concur. The department will work with the Department of Revenue to report state land pursuant to state law.



**12) We recommend the department process surface and ground water rights applications in the timeframes required by state law.**

Concur. These deadlines were based on the level of activity and water use development methods that were present in 1973. Since then several water basins have been closed to various uses of water and applications for changing and leasing existing water rights have profoundly increased in complexity. More applications are receiving objections and applications are reviewed for impacts under MEPA. Montana Courts have ruled these deadlines are “advisory”; they are not fatal to the Department’s jurisdiction or the applicant’s standing.

New administrative rules are being promulgated that will help speed up the process. The Department has just recruited a second hearings examiner. In addition, seven regional managers have been assigned to conduct hearings to alleviate the backlog of hearing files.

**13) We recommend the Department review state water reservations as required by state law.**

Concur. There has been minimal activity in developing the water reservations by municipalities and the federal government. In addition, no irrigation reservations can be developed in the upper Missouri River basin due to the closure of the basin to new surface water irrigation. Conservation Districts already report annually what their development has been and this information is current in the water right database.

The Legislature extended the duration of the Yellowstone water reservations until they are perfected or revoked. They initially had 30 years to be developed. Removing the term deadline fully supported the original intent of the water reservations, which was to provide for future water needs.

With the intent in mind, it may be appropriate to seek a legislative change to remove the specific ten-year period and allow the Department to make this comprehensive review when it determines appropriate. Changes, transfers and reallocations of water reservations are within the Department’s authority. To date there has been no competing interest seeking to alter the status of the current reservations; however if interest presents itself, these provisions in the law allow the Department to review the objectives and the option to change the reservations.

The Water Rights Bureau will notify reservants of this requirement and will establish reporting content needed to satisfy this statute.

**14) We recommend the Department submit fire cost protection assessment information by the deadline established in state law.**

Concur. DNRC will continue to work toward meeting the August 12 deadline. However, the Forestry Division relies on the county treasurers to provide necessary information, and they often do not receive that information in time to meet the deadline. The Department will continue to monitor this situation, but may request a law change in the 2007 legislative session to change the deadline set in state law.

- 15) **We recommend the Department establish procedures to ensure its annual Schedule of Expenditures of Federal Awards and summary of subgrant activity are complete and contain accurate information as required by OMB Circular A-133 and the Single Audit Act Amendments of 1996.**

Concur. The Department will ensure the Schedule of Expenditures of Federal Awards and summary of subgrant activity are complete and accurate.